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# Supreme Court of the United States.

OCTOBER TERM, 1964.

No.

WILLIAM H. LEGATE,
*Petitioner,*

*v.*

J. JOSEPH MALONEY, JR., RECEIVER,
*Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

The petitioner, William H. Legate, respectfully prays that a writ of certiorari issue to review that portion of the judgment of the United States Court of Appeals for the First Circuit in the above-entitled case which denies the petitioner's claim for rescission of the agreement for limited partnership in the stock-brokerage firm of duPont, Homsey & Company (hereinafter called "firm").

## Opinions Below.

The Court of Appeals deals with said claim for rescission at pages 705 to 708 of its opinion reported in 334 F. 2d 704, and printed as Appendix A, *infra.* Said claim for rescission was referred to by the District Court in its Memorandum opinion of May 1, 1962, reported in 204 F. Supp. 944 (which is printed at page 68 of the record) and in the

opinion confirming the master's report filed October 10, 1963 (printed at page 177 of the record).

## Jurisdiction.

The judgment sought to be reviewed was entered on August 5, 1964, a petition for rehearing having been denied on said date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## Question Presented

The question presented on this petition is whether Homsey's representations and failure to disclose to the petitioner the facts (detailed below) entitle the petitioner to rescission of the agreement for limited partnership in the firm and to allowance of his claim for the $30,000 in cash and $51,162.50 in securities obtained from him on February 28, 1959, in connection with such agreement.

## Statutes, Rules and Regulations Involved.

The pertinent portions of the statutes, rules and regulations involved (set forth in Appendix B) are as follows:

Securities Exchange Act of 1934.

| | |
|---|---|
| § 3 (13) and (14) | 15 U.S.C. § 78c (13) and (14). |
| § 8 | 15 U.S.C. § 78h. |
| § 10 (b) | 15 U.S.C. § 78j (b). |
| § 29 (b) | 15 U.S.C. § 78cc (b). |

Rule 10b-5 of Securities Exchange Commission.

Section 220.5 of Regulation T of Board of Governors of the Federal Reserve System.

## Statement of the Case.

Pertinent to the questions presented here, the facts established by the master's subsidiary findings as well as by exhibits from the files and records of the Exchange showed the following:

The petitioner, born in 1912, ended his formal education with his graduation from Worcester High School. He then worked at various jobs until 1938, when he started a retail paint business for himself in a store in Southbridge, Massachusetts (R. 110). In the second world war he served in the Army Air Corps and attained the rank of first lieutenant (R. 110), the business being meanwhile run by his wife. In connection with his military duties the Army Air Corps sent him to Holy Cross College for about six months (R. 110). After the war the petitioner, while continuing with the Southbridge business, opened, in 1950, a retail paint business in a store in Webster, Massachusetts, and, in addition, he engaged also in the wallpaper and interior-decorating business (R. 110).

In the spring of 1958 the petitioner became acquainted with Homsey, the senior and managing partner of the stock brokerage firm of duPont, Homsey & Co. (R. 110). This was after the petitioner's health had broken down and his doctor had ordered him to retire from all business activities (R. 111). Accordingly, he sold his business and began considering a plan to move to California (where his married sister was living) and to invest his savings in "California deeds of trust" (R. 111). In the latter part of February, 1959, he consulted Homsey in regard to the safety of his proposed investment in the deeds of trust (R. 111). He had, by that time, become well acquainted with Homsey, in whom he placed implicit trust and confidence (R. 111). Homsey counselled the petitioner against investing in the trust deeds, and persuaded him instead to hand over to

Homsey $30,000 in cash and $51,162.50 in securities under an agreement dated February 23, 1959, for limited partnership in his firm (R. 111).

In contrast to the petitioner, with his limited education and experience in business, Homsey had been a stockbroker for many years and, since 1949, a member of the Exchange (R. 60). During the summer of 1958 petitioner served as a companion to Homsey and mingled with Homsey's coterie of friends and customers (R. 111).

**The Material Facts Concealed by Homsey from the Petitioner.**

In February, 1959, Homsey told the petitioner of his high standing, and that of his firm, with banks and financial institutions, and of their "impeccable" standing with the Exchange (R. 118). The master found that the petitioner believed and trusted Homsey implicitly and relied upon his "articulations" (R. 120); and the District Court said that Legate "trusted Homsey completely" (R. 179).

The master's subsidiary findings show that Homsey failed to disclose, and that the petitioner did not learn until after the receivership, any of the following material facts bearing strongly on the true financial standing and stability of Homsey and his firm and on the "safety" of the investment therein which Homsey was urging upon the petitioner in February, 1959, to wit:

(1) That Homsey and his firm had been found guilty by the Exchange, more than once, of violations of the rules and regulations applicable to brokers (R. 119).

(2) That for such violations both general partners of the firm (Homsey and Colby) had been summoned by the Exchange on more than one occasion and that they individually and the firm had received formal and severe censures and strict warnings (R. 119).

(3) That on two such occasions fines had actually been imposed by the Exchange for such violations (R. 119).

(4) That as a result of such violations the firm had been reduced by the Exchange to a status lower than standard, a status in which the firm's permissible ratio between aggregate indebtedness and net capital was lowered from 2,000% to 1,750% and in which the firm was required to maintain a minimum capital of $60,000, instead of only the $50,000 ordinarily required of member firms by Rule 325(a) of the Rules of the Exchange (R. 119, and Exhibit 44(b), R. 147).

(5) That, contrary to section 8(a) of the Act and section 220.5 of Regulation T, whereby stockbrokers are strictly limited to but three sources for borrowing, Homsey had, in fact, been borrowing since 1953 "against marketable securities" (R. 117) from forbidden sources—namely from various private money-lenders substantial sums; that those borrowings were at interest rates ranging from 12 to 18% per annum; and that three of those illegal borrowings, aggregating $108,500, were still outstanding and unpaid on February 23, 1959, and that they remained outstanding until after September 17, 1960, which followed the suspension from the Exchange of both Homsey and the firm; and that those outstanding loans were liquidated only through the sale of the securities by the money-lenders (R. 117).

(6) That Homsey had been concealing all such borrowings from the Exchange, in violation of Rule 416 of the Exchange, although specific questions in both the "long form" and "short form" questionnaires submitted annually by the Exchange required the disclosure therein to the Exchange of all borrowings in excess of $2,500 by general partners of member firms (R. 118).

(7) That by letter dated November 12, 1958 (R. 151-152), the Director of the Department of Member Firms had called Homsey's attention to the firm's then slim capital

position, to the large number (74,697) of "not actively traded" shares of American Petrofina being carried by the firm, and to the decision therefore reached by the Exchange, "effective December 15, 1958," to reduce substantially the value to be assigned to such shares in computing the firm's net capital. The following paragraph of that letter makes plain the critical situation of the firm.

> "Included in proprietary positions were 74,697 shares of American Petrofina 'A' stock valued at $746,-970. While this security is listed on the American Stock Exchange a study of the volume of transactions over a ten month period indicates that it is not actively traded and that it would be difficult to liquidate a block of the size you presently hold without seriously affecting the market price. For these reasons we have determined that effective December 15, 1958, we will allow 70% of the market value of the first 20,000 shares and 50% of the market value of the remainder when computing your firm's net capital under Rule 325 of the Board of Governors. We realize that this decision will materially affect the capital position of your firm and it is for this reason that we are delaying the effective date of this treatment until December 15, 1958 in order that you may make any changes you deem necessary to assure continued compliance with Rule 325 of the Board of Governors." (R. 152.)

(8) That, in addition to the concealments referred to in paragraphs (1) to (7) above, Homsey concealed from the petitioner the fact that early in February, 1959, an examiner of the Exchange (Beliakow) had informed Homsey that his written report to the Exchange disclosed violations of the net-capital rule and also several violations of Regulation T as well as violations of Rule X 8C-1 and 2 of the

SEC relating to commingling of customers' and proprietary securities (R. 147-148; Ex. 44(b)). The Beliakow report made it plain that the firm was then in serious danger of being subjected to further, and possibly much more decisive, disciplinary action by the Exchange. The Beliakow report stressed the danger of such action in view of the firm's prior violations and of the previous disciplinary measures by way of censures, warnings and fines (R. 119; Ex. 44(b), R. 147, at 149; Ex. 58, R. 151; and Ex. 60, R. 152).

(9) That, as a result of the violations disclosed in the Beliakow report, Homsey began, on February 18, 1959, negotiations for the sale to White, Weld & Co. of 70,097 shares of American Petrofina, then carried in the firm's portfolio (R. 120). Only between 2,000 and 2,500 of such shares were being traded per day on the regular exchange (American Stock Exchange) in February, 1959 (R. 119). The master found that Homsey's negotiations for the sale of those 70,097 shares were not completed until February 25, 1959, two days after Homsey had obtained from the petitioner the agreement for limited partnership. White, Weld & Co. agreed to buy those shares "as agents for themselves and Hemphill Noyes and Co." The master further found that "the sale was made outside the regular market for payment on March 3, 1959"; and that the cost of such sale to the firm was $51,170.81, whereas a sale of those 70,097 shares on the regular market would have cost the firm only $12,250 (R. 120).

(10) This sale, made "outside the regular market" and at such excessive cost, did not satisfy the Division of Finance of the Department of Member Firms, as appears by the letter, dated March 13, 1959, from the head of that division (Ex. 44b, R. 147-150). That letter called to Homsey's attention the fact that the Beliakow report listed not only violation of the capital rule, but also a number of viola-

tions of Regulation T and of Rule X8C-1(a)(2). That letter told Homsey pointedly that a report of those violations "will be presented to the Advisory Committee of the Board of Governors for its consideration" (R. 148). Thus, on the basis of the Beliakow report, there was imminent danger that the firm and its two general partners would again be summoned before the Exchange Advisory Committee.

(11) The memorandum of April 16, 1959, from the Director of the Department of Member Firms to his superior in the Exchange (R. 153-155) called attention to the three prior occasions when the firm had been censured, warned and fined, and also to the Beliakow report. Though making no reference to the several violations of Regulation T and Rule X8C-1(a)(2) listed in the Beliakow report, that memorandum said that the situation in respect to the shares of American Petrofina "demonstrates very clearly that he [Homsey] was skating on very thin ice particularly in view of the warning given by the Board" (R. 155).

(12) The following paragraph of the letter to Homsey of April 22, 1959, from the Director of the Department of Member Firms reveals clearly that Homsey and the firm were indeed "skating on very thin ice." That letter says:

> "We expect that there will not be another occasion on which your firm is found to be in violation of the minimum capital requirements of the Exchange. If this should happen *even though it might be the result of a miscalculation on the part of your firm* or a violation due to a substantial reduction in a large block of a security, we will have no option but to report the incident to the Advisory Committee for whatever decision they might wish to reach." (Emphasis supplied.) (Ex. 60A, R. 155, at 157.)

It was by means of the concealment of those material facts that the petitioner, in poor health and therefore con-

cerned with safety in investment, was induced by Homsey to forego investing his funds in California trust deeds, and, instead to enter into the agreement of February 23, 1959, and pursuant thereto, to turn over to Homsey the $30,000 in cash and $51,162.50 in securities (R. 111-113).

In that agreement, signed by Homsey individually, he guaranteed not only monthly payment of interest, but that the petitioner "will not suffer any losses through partnership" (R. 112). In view of this obligation of Homsey individually, it seems clear that his concealment of the fact of his personal indebtedness for the large borrowings at the high rates of interest had an important bearing on the petitioner's reliance on Homsey's said guaranty of monthly interest payments and Homsey's agreement to hold the petitioner harmless from "any losses through partnership," especially in view of Homsey's representations as to his affluence, as to his and the firm's high standing with banks and financial institutions, as to their "impeccable" standing with the Exchange, and as to the safety of the investment which Homsey was urging upon the petitioner.

Those facts (established by the master's subsidiary findings as well as by the incontrovertible exhibits referred to above) as to matters concealed from the petitioner and as to the representations made to him show clearly that Homsey and his firm were, in February, 1959, "skating on very thin ice," and were, to Homsey's knowledge, again in critical danger by reason of a number of violations, and were, in fact, in a situation far different from what the petitioner had been induced by Homsey to believe.

**Reasons for Granting the Writ.**

The reasons for granting the writ are:

(*a*) In view of the petitioner's complete trust and confidence in Homsey as his stockbroker and financial adviser

and in view of the misrepresentations made and of the facts concealed by Homsey (detailed in paragraphs 1 to 12 above), the court below, in denying rescission, applied standards of conduct which are in conflict with the high standards applicable under the decisions of this Court, as well as under the decisions of federal appellate courts in other circuits in matters within the purview of the Act and of the regulations and rules promulgated thereunder.

(*b*) The petitioner is entitled to rescission because by said misrepresentations and concealment of material facts Homsey violated the high standards of frankness and of ethical conduct required of him in inducing the petitioner to part with his $81,162.50 in cash and securities.

(*c*) In denying rescission, the Court of Appeals decided an important question of federal law which has not been, but should be, decided by this Court for the guidance of the numerous stockbrokers and financial and investment advisers as well as for the benefit of the large segment of the public investing and dealing in marketable securities.

## Argument.

By reason of the petitioner's inability to earn a living, owing to his poor health, he was of course concerned with safety for the investment of his funds. He naturally turned for advice to Homsey, who had been, since about the middle of 1958, his financial adviser and also his stockbroker in connection with his customer account with the firm and in whom he had complete confidence. Homsey's representations as to his "affluence" and as to his and his firm's stability, good reputation and "impeccable" standing "impressed" the petitioner (R. 111, 118).

Homsey advised him to "forego" his plan to invest in "California Deeds of Trust," and persuaded him to enter

into the agreement of February 23, 1959, and to part with the cash and securities on February 28, 1959 (R. 111-113). But, in giving that advice, Homsey concealed from the petitioner the material facts set forth in paragraphs 1-12 above, and the petitioner entered into said agreement and turned over said cash and securities without knowledge thereof (R. 118).

In making said representations to the petitioner without disclosing said facts to him, Homsey's conduct was plainly in conflict with the high standard of conduct required of Homsey in the circumstances, under decisions of this Court.

In *Securities & Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 84 S. Ct. 275 (1963), this Court, in speaking of the "series" of Congressional Acts, which included the Securities Exchange Act of 1934, "designed to eliminate certain abuses in the securities industry," says:

> (At page 186:) "A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry."
>
> (At page 194:) "Courts have imposed on a fiduciary an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients."

In *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 83 S. Ct. 1246 (1963), this Court says:

> (At p. 366:) "It requires but little appreciation . . . of what happened in this country during the 1920's

and 1930's to realize how essential it is that the highest ethical standards prevail . . ."

And in the *Capital Gains* case this Court, after quoting the foregoing standard from the *Silver* case, says that it applies in "every facet of the securities industry" (p. 187).

Homsey's conduct was also in conflict with Rule 10b-5, adopted by the SEC pursuant to section 10(b) of the Act, particularly with subsection (a) thereof, for, by concealing said facts, Homsey did "omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." His conduct was also in conflict with subparagraph (3) of that rule, since it prohibits "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase and sale of any security."

*Charles Hughes & Co., Inc.*, v. *Securities & Exchange Commission*, 139 F. 2d 434 (C.C.A. 2d, 1943), at 437.

*Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D.C. Del. 1951), at 829.

*Securities & Exchange Commission* v. *Torr*, 15 F. Supp. 315 (D.C. S.D. N.Y. 1936), at 317.

The opinions of the courts below show plainly that rescission was denied because they applied the rules and philosophy of *caveat emptor* instead of the "philosophy of full disclosure . . . and thus to achieve a high standard of business ethics in the securities industry," the standard which this Court prescribed in *Silver* v. *New York Stock Exchange* and in *Securities & Exchange Commission* v. *Capital Gains Research Bureau, Inc., supra, to be applied "in every facet of the securities industry."*

The petitioner was entitled to rescission, not only under the Act and the rules and regulations promulgated thereunder, but also under established principles of equity.

*Madigan* v. *McCann*, 1963 Mass. Adv. Sh. 647, 649, and cases there cited.

*Oteri* v. *Scalzo*, 145 U.S. 578, 12 S.Ct. 895, 898.

*Knapp* v. *First National Bank & Trust Co. of Oklahoma City*, 154 F. 2d 395 (C.C.A. 10th, 1946), at 396.

*Smith* v. *Gibson*, 310 Ky. 114, 220 S.W. 2d 104, at 105.

*Waller* v. *Henderson*, 135 Okla. 231, 275 P. 323, at 325.

*Zogg* v. *Hedges*, 126 W. Va. 523, 29 S.E. 2d 871, at 873.

*Biagi* v. *Gregory*, 19 Ill. App. 2d 534, 154 N.E. 2d 849, at 854.

By reason of the candor and frankness required of Homsey, the petitioner is entitled to rescission, even if there were no pecuniary loss.

Williston on Contracts (Rev. Ed.) vol. V, § 1525, at page 4271.

*Commercial Credit Corp.* v. *Third & L Sts. Garage*, 234 N.Y.S. 463, at 468 and 469.

The record shows that there is a surplus of receivership assets amounting to about $100,000 after payment in full to all creditors and claimants (R. 198), except only (*a*) the claim of the petitioner for the cash and securities that were obtained from him on February 28, 1959, in connection with said agreement, and (*b*) the claims purchased by the Exchange which the respective assignors had expressly subordinated in writing to all claims entitled to

creditor status. Such express and clear subordination had been made by said respective assignors, each "for himself, his heirs, personal representatives, successors and assigns" by the "Consent, Waiver and Subordination" prescribed by the Receiver's Plan for Partial Liquidation. By said instrument, each also waived "any right to share in any part of the assets now in, or hereafter coming into the hands of the receiver or to receive any share thereof unless and until all customers and creditors of the defendant duPont Homsey & Company have been paid in full" (R. 33, 34).

There can be no doubt that, in the clear absence of any creditors, the granting of rescission would entitle the petitioner to creditor status with respect to his claim for the $81,162.50.

Securities Exchange Act of 1934, § 29(b) (15 U.S.C. 78cc(b)).

*Petition of Williams*, 297 Fed. 696; cert. den. 265 U.S. 593, 44 S. Ct. 638.

## Conclusion.

It is therefore respectfully submitted that a writ of certiorari should be issued to the United States Court of Appeals for the First Circuit so that the denial of rescission claimed by the petitioner may be reviewed by this Court.

Respectfully submitted,

MARK M. HORBLIT,
Attorney for petitioner.

Of Counsel:

SAMUEL H. FALISH,
PETER R. TRITSCH.

Dated at Boston, Massachusetts, October, 1964.

## Appendix A.

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WILLIAM H. LEGATE, Claimant, Appellant,

*v.*

J. JOSEPH MALONEY, JR., Receiver, Appellee.

No. 6287.

United States Court of Appeals
First Circuit.

July 13, 1964.

ALDRICH, Circuit Judge.

This is an appeal from a final judgment of the district court, entered under F.R. Civ.P. 54(b) following a memorandum decision, reported in Securities & Exchange Comm. v. duPont, Homsey & Co., 204 F.Supp. 944, and a further opinion and order confirming, except in one respect, a detailed report of a special master. An earlier appeal was ordered dismissed as premature. Legate v. Maloney, 1 Cir., 1962, 308 F.2d 228, cert. den. 372 U.S. 912, 83 S.Ct. 721, 9 L.Ed.2d 720. The questions arise in a receivership proceeding instituted on the complaint of the Securities and Exchange Commission winding up a brokerage firm, du Pont, Homsey & Company, of which one Homsey was the managing partner. The firm was a member of the New York Stock Exchange, hereinafter the Exchange. Legate, the appellant, was, for the final year and a half, a limited partner. A retired small businessman, he had previously been a customer of the firm, and continued to be one. In the receivership proceeding appellant sought to rescind his limited-partnership agreement and to make claims as a creditor in lieu thereof, and to establish certain priorities. Alternatively, he claimed items allegedly due him under the agreement. Conversely, the receiver, appellee herein, sought, by way of counterclaim, to recover withdrawals by

appellant from his capital account, allegedly in violation of the agreement. Also involved were various claims and cross-claims on appellant's customer's account by, and against, the receiver and for certain other relief. Finally, appellant sought to establish a claim against the Exchange, which the court declined to hear.

We have considered appellant's many contentions, *legal as well as factual,* but find only *three* requiring discussion. And with respect to these, since the evidence has not been reported, we must accept the master's findings and conclusions unless inconsistent or plainly wrong in the light of his subsidiary findings.

Our decision as to appellant's claim of rescission could rest upon either of two grounds. In the first place a limited partnership is wholly statutory. Lancaster v. Choate, 1863, 5 Allen (Mass.) 530. Under Massachusetts law it may be doubted whether even a limited partner may assert equitable rights as against innocent creditors. See Mass. G.L. c. 108A §§ 6(2), 39(a) and (b); c. 109 § 29. For the earlier equity rule see, e. g., Richards v. Todd, 1879, 127 Mass. 167; Perry v. Hale, 1887, 143 Mass. 540, 542, 10 N.E. 174; 1 Rowley, Partnership § 39.0, at p. 753 (2d ed. 1960); Lindley, Partnership 599 (11th ed. Salt & Francis 1950); see also Van Andel v. Smith, 10 Cir., 1957, 248 F.2d 915, 918. One of the incidents of a limited partnership, no less than of a general partnership, is that representations as to capital contributions are made to the creditors of the firm. Cf. Mass.G.L. c. 109 §§ 2, 16, 17 and 23. In the case of Richards v. Todd, supra, on which appellant relies in other particulars, the court carefully restricted the effect of rescission *ab initio* to "as between the parties," and declared that since the defrauded partner "by holding himself out as a member of the firm rendered himself liable to creditors of such apparent firm," he was entitled to an indemnity.

Id., 127 Mass. at 173. None of appellant's cases holds to the contrary.

[1] However, it is not necessary to reach this broad question. Appellant has not shown as plainly wrong the master's conclusory finding that the conduct of Homsey, "insofar as it is a question of fact, does not afford a basis for rescission." Appellant speaks of misrepresentation and concealment. *We recognize no relationship here which would condemn concealment, as such, apart from the extent that such concealment might have made any affirmative representations materially false.* Nor are we concerned with cases cited by appellant where a party concealed the fact that he was obtaining a secret advantage, and so could be said to have made an implied misrepresentation.

The affirmative representations found by the master were as follows.

1. That the firm was stable and of good reputation, and its standing "impeccable." The master found that "the partnership was not below standard financially."[1] He also found that the basis for prior criticisms of the firm's failure to meet certain capital requirements of the Exchange had been attended to and cured. To the extent that any greater standing or repute was implied in the above characterizations, or by the word "impeccable," this would seem a typical example of seller's talk or "puffing." Deming v. Darling, 1889, 148 Mass. 504, 20 N.E. 107, 2 L.R.A. 743, cited with approval in Fogarty v. Van Loan, 1962, 344 Mass. 530, 532, 183 N.E. 2d 111; Boston Consol. Gas Co. v. Folsom, 1921, 237 Mass. 565, 130 N.E. 197.

2. That an investment in the firm would be "safe" and "profitable." This is mere classic "prophecy." Lynch

1. It is true that because of prior infractions of its regulations the Exchange required the firm to maintain a higher margin of credit than usual, a matter Homsey did not disclose to appellant However, the firm did thereafter conform. Neither the infraction nor the conformance has been shown to have injured the firm.

v. Pennsylvania R. R., 1947, 320 Mass. 694, 695, 71 N.E.2d 114; Harris v. Delco Products, Inc., 1940, 305 Mass. 362, 25 N.E.2d 740; Fogarty v. Van Loan, supra.

3. That Homsey was "affluent." Whatever this may mean,[2] appellant's evidence to indicate its untruthfulness, that Homsey made expensive personal borrowings from money lenders, established, on the master's findings, nothing which "jeopardize[d] the position of the firm in any way."

4. Finally, the master found that appellant "was impressed by * * * the Exchange's advertising campaign * * * to place faith in the firm" because of its membership. Possibly because the court refused to entertain appellant's attempted claim against the Exchange he failed to introduce evidence of what sort of representations the Exchange made, or, at any rate, failed to bring them to our attention. We cannot, accordingly, consider them for present purposes as having been actionable misrepresentations as distinguished from mere general puffing.

Summarizing, even if appellant's rescission claim is taken at its full value, the only matters that were kept from him related to circumstances which had caused, or in some cases merely had threatened to cause, past violations of certain fiscal requirements of the Exchange. There was no misstatement as to any present violation, or as to existing assets, or, in any substantial matter, as to any firm liability. Nor did these events of which appellant complains reflect upon Homsey's morals or ethics. The debacle came from Homsey's launching into a career of manipulation and embezzlement following appellant's entry into the firm, and was not shown to be connected with any prior event. While, conceivably, he might have found the other way, the mas-

2. The master did not find, in the words of appellant's brief, that Homsey said he was "a millionaire."

ter's conclusion that appellant was not materially misled was not plainly wrong.

[2] However, when we come to a charge on Legate's customer's account (as to one item, only) and the master's handling of the receiver's claim that Legate should be held responsible for Homsey's misconduct because of his failure to disclose Homsey's misdoings before matters reached irremediable proportions, we have difficulties.[3] In November 1959 Homsey purchased 1000 shares of American Motors. The trading slips were all in Homsey's handwriting, but showed Legate as the purchaser. There is no indication that Legate knew anything of this, and the shares were subsequently paid for by the firm. In January 1960 Homsey purchased 2000 shares of Studebaker-Packard. These, too, were paid for by the firm. On February 11 Legate and Homsey went to Florida to visit some friends of Homsey's. Before departing Homsey told Legate that for procedural reasons he had put "a few shares" of American Motors and Studebaker-Packard in Legate's account. Legate protested, saying that he did not want the shares and had no money to pay for them. He was finally prevailed upon to give Homsey two blank checks, with the understanding that the entire transaction was to pass through him simply for the firm's bookkeeping purposes, that the stock was not to belong to him, that his account would be credited with firm money before his checks were negotiated, and that the whole matter would be shortly taken taken off the books so far as he was concerned. On Legate's return from Florida in April or May he discovered that the matter had not been taken off the books. On the contrary, his account stood debited as of February 18 with $107,481 as the balance due, over and above the checks,

3. The master found against the receiver as to this latter issue, and he has not appealed, but the relevancy of this portion of the case will appear later.

to pay, not for "a few shares," but for the 3,000 shares above stated. The prices charged to him, incidentally, were Homsey's initial purchase prices, and not the substantially reduced value of the stock as of February 18. Legate protested to Homsey, and was told that the matter would be taken care of. At the time he received a statement from the firm's accountants showing these transactions as his. He twice refused to sign an acknowledgment of the correctness of the statement. On the other hand, he did not say why, but kept his own counsel. Nor, apparently, did he again check back to see whether Homsey had righted the matter. In fact, Homsey sold out the stock in June at a "loss" to Legate's account of $17,693.

In spite of having made all of the above specific findings the master concluded, apparently because it was not unusual for Legate to trust Homsey with blank checks, that Legate had "authorized" the personal acquisition of this stock, and so was chargeable with the loss. In our opinion such a conclusion, either by way of authorization or ratification, cannot stand in the light of these subsidiary findings. Legate may have been over-trusting, but as between himself as a customer and the firm he was not a purchaser.

[3] Singularly enough, when he came to the receiver's claim against Legate because of his failure to disclose that Homsey was playing fast and loose with his account and so might be doing the same with others, the master proceeded on a quite different basis. If, in fact, Legate had authorized the American Motors and Studebaker-Packard transactions Homsey's maximum misconduct was an overextension of credit to Legate. The master did not treat Legate's non-communication on this basis. Rather, he expressly found that Legate "did not report the matter to anyone but Homsey because he felt that Homsey 'would take care of it' and that these securities would be taken off

his account." Yet obviously there could be no reason for the shares to be taken off Legate's account if he had authorized the transaction as a purchase rather than as a bookkeeping convenience "to be taken care of" by Homsey.

The master's findings in these two matters are irreconcilable. For the reasons stated an adjustment must be made with respect to the claimed $17,693 loss which the receiver debited against Legate's account.[4]

[4] Consideration of appellant's dismissed petition against the Exchange, which asserted misrepresentation, non-disclosure, and failure to live up to its rules and regulations, but for which, allegedly, he would not have been induced to become a member of the firm, requires a further recitation. The Exchange is, and has been at all times presently material, the assignee (by payment) of certain substantial customers' claims against the firm, claims which under no eventuality will be fully satisfied. Indeed, although the receiver exists as a separate party, and will have certain personal claims, *the real parties in interest and in competition with each other in the present proceedings are appellant and the Exchange.* This fact is not concealed by the circumstance that the Exchange has assigned its interests to an attorney who, it so happens, is representing the receiver on this appeal.[5] As the Exchange's "nom-

4. This might, correspondingly, suggest a reopening of the master's finding in Legate's favor with respect to his non-disclosure of Homsey's misconduct. While we do not decide that even though the receiver has not appealed we have no authority to reopen that matter if otherwise there would be an evident miscarriage of justice, this could not be the case here. As we have pointed out, the master's finding against the receiver already assumed that Legate had knowledge of the impropriety of this transaction.

5. It is to be noted that six pages of the "receiver's" brief are devoted to arguing that the petition which appellant sought to have heard against the Exchange was properly dismissed for lack of jurisdiction.

inee'' or alter ego he filed a claim in the general receivership proceedings, and is and was directly financially interested in various aspects, particularly in the receiver's claim against appellant for failure to disclose Homsey's misdoings. In fact in the Receiver's Counterclaim which he signed as counsel for the receiver it was asserted, *inter alia,* that appellant's non-disclosure was a violation of his ''duty to * * * the Exchange.'' While, perhaps, this allegation was only a makeweight for the receiver's claim on behalf of the creditors as a whole, it is an apt reminder of who those creditors really are.

This is an equitable proceeding. It cannot be that the Exchange can come in as a claimant through a nominee, and through the receiver prosecute claims against appellant for its ultimate benefit, and then say, either as a matter of right or of the district court's discretion,[6] that it is not ''here'' when appellant wishes to fight back. We see no impropriety in the Exchange being represented by a nominee, as a matter of procedure, even when that nominee acts for the receiver as well, so long as there is no conflict of interest. But the Exchange cannot stick its head in the sand and avoid the normal consequences of its presence. One of those consequences is that it must be here defensively as well as aggressively. Alexander v. Hillman, 1935, 296 U.S. 222, 241-42, 56 S.Ct. 204, 80 L.Ed. 192. The order dismissing appellant's petition was error.

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6. The district court appears to have dismissed appellant's petition against the Exchange on both grounds. Seemingly it was misled by the nominee arrangement, for its opinion recites, ''The Exchange is asserting no claim against the assets of the receivership,'' a statement that is echoed in the receiver's brief. It is hard to see how that is so. The fact that, for reasons not worth developing, the Exchange by its nominee became a claimant under circumstances that might entitle it to be termed a Good Samaritan, does not meet the fact that any generosity on its part was not directed towards eliminating claims against appellant. Rather, the Exchange would be the direct beneficiary of those claims.

Judgment will be entered vacating the judgment of the district court and remanding the action for further proceedings not inconsistent herewith.

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## Appendix B.

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STATUTES, RULES AND REGULATIONS INVOLVED.

Securities Exchange Act of 1934, § 3 (15 U.S.C. § 78c):

"(13) The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire.

"(14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

Securities Exchange Act of 1934, § 8 (15 U.S.C. § 78h):

"It shall be unlawful for any member of a national securities exchange, or any broker . . . directly or indirectly—

. . . . . .

"(c) In contravention of such rules and regulations as the Commission shall prescribe for the protection of investors to hypothecate . . . any securities carried for the account of any customer under circumstances (1) that will permit the commingling of his securities without his written consent with the securities of any other customer . . ."

Securities Exchange Act of 1934, § 10 (15 U.S.C. § 78j):

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality

of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . . . . .

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Securities Exchange Act of 1934, § 29(b) (15 U.S.C. § 78cc(b):

"Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder . . . heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract . . ."

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Rule 10b-5 of Securities and Exchange Commission:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(1) to employ any device, scheme, or artifice to defraud,

"(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

Regulation T of Board of Governors of the Federal Reserve System:

"SECTION 220.5—BORROWING BY MEMBERS, BROKERS, AND DEALERS

(a) General rule.—It is unlawful for any creditor, directly or indirectly, to borrow in the ordinary course of business as a broker or dealer on any registered security (other than an exempted security) except:

(1) from or through a member bank of the Federal Reserve System; or

(2) from any nonmember bank which shall have filed with the Board an agreement which is still in force and which is in the form prescribed by this part; or

(3) to the extent to which, under the provisions of this part, loans are permitted between members of a national securities exchange and/or brokers and/or dealers, or loans are permitted to meet emergency needs."